IN THE

Supreme Court of the United States

OCTOBER TERM, 1939

No. 681

RAILROAD COMMISSION OF TEXAS ET AL,
Petitioners

VS

ROWAN & NICHOLS OIL COMPANY,
Respondent

BRIEF FOR RESPONDENT

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

SUBJECT INDEX

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AUTHORITIES

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STATEMENT IN RESPECT TO JURISDICTION

After Petitioners perfected their appeal to the Circuit Court of Appeals, the Railroad Commission promulgated, and is now enforcing, orders to control production of oil from the East Texas Field which are substantially different from the order and plan of proration involved in this suit. The difference in the orders and methods of proration appears to be material in that the daily field allowable has been increased from approximately 522,000 barrels to approximately 690,000 barrels, and in that the daily field allowable is prorated among wells on a different formula from the basis of proration under attack in this suit. Petition-

ers construe the decree in this suit as affirmed by the Circuit Court of Appeals to prevent their enforcing such new order to control production from Respondent's Todd "B" lease and are allowing Respondent to produce under the decree. These facts do not appear in the record, but it is not believed that they will be controverted by Petitioners, and in the belief that it is proper to state them, they are stated because of their bearing upon, if they do bear upon, questions of jurisdiction.

STATEMENT OF CASE

Petitioners' statement of the case does not, in Respondent's view, sufficiently state the case and does not in all particulars conform to Respondent's understanding of the record.

Respondent alleged that its Todd "B" lease, covering 25 acres, is favorably situated on the structure, has large reserves, high pressures and high potentials; that the Railroad Commission's method of prorating the daily field allowable among wells in the East Texas Field was substantially a per well distribution of the field allowable, and allowed to densely drilled tracts and tracts with small reserves a disproportionate part of the field allowable and gave them an unjustified advantage over better and less densely drilled leases, like Respondent's lease, having approximately 95 feet of sand and drilled to a density of only one well to about five acres; that under this method of proration Respondent's lease was being drained and was not being allowed currently, and would not be allowed ultimately, to produce its fair share, or proportionate share, of the reserves of the field; that this method of proration was not necessary to prevent waste or otherwise protect

the public interest; that the regulation had the effect to deprive Respondent of its property and to deny to it the equal protection of the laws, in violation of the Fourteenth Amendment to the Constitution of the United States. Respondent prayed that this method of distributing the field allowable be adjudged invalid and that Petitioners be enjoined from further enforcing such method of regulation to prevent Respondent producing its fair share of the oil. (R., 1-16, 43-47)

The findings of fact were based on testimony which is practically undisputed on material points. Although Petitioners did not except to the findings of fact or request that they be modified or that additional findings be made, and, as Respondent understands, do not here question the sufficiency of the evidence to support the findings, they argue the suit from the testimony and not from the findings. Respondent will state the controlling findings of fact because in Petitioners' statement of the case and throughout the brief there are numerous statements purportedly based on the testimony of witnesses, but in conflict with the findings of the trial Court. For example, the statement that the portion of the field in the vicinity of Respondent's lease will produce longer than any other part of the field and be drowned out last, the inference being that Respondent's lease will be among the last to go to water, is in direct conflict with express finding of the trial Court (R., 985, supported by testimony, R., 622-624, 583) that water will drown out Respondent's wells before it drowns out wells to the east and up-structure from Respondent's lease. Again, the statement at one point that there is now as much oil beneath the surface of Respondent's lease as when the field was discovered and at another point that there is

substantially the same amount of oil beneath Respondent's lease as originally, is calculated to confuse because the statement ignores the difference between oil in place and recoverable oil in place, and also ignores the finding of the trial Court (R., 976-977, supported by evidence, R., 311-312) that there is less recoverable oil now under Respondent's lease than originally, and the finding of the trial Court (R., 987, supported by evidence, R., 603-608) that under the present plan of proration Respondent will not be permitted ultimately to recover an amount of oil equivalent to its original recoverable reserves.

In the following statement of the controlling findings, references to the findings of fact are in bold face type.

The East Texas Field is a common reservoir; the producing sand is 3,600 feet below the surface; a cross-section of the field resembles a triangle, the long or top side of which is in the plane formed by the bottom of the Austin Chalk, an impervious formation, the lower or west side of which is a line in the plane of oil-water contact, the eastern side of which is a line in the plane formed by the top of the Georgetown lime, an impervious formation; water is under the western part of the producing area; the pressure of the water is the principal source of reservoir energy; the center of the field, running from north to south, is the area of maximum sand thickness, where the sand is approximately 100 feet thick; from the center of the field to the east, and also to the west, the producing sand becomes thinner, until it pinches out at the edges of the field; with the exception of a few areas of no consequence with respect to the issues here involved, fluids move freely

through the sand from areas of high pressure to areas of low pressure; while some portions of the producing horizon are more porous and more permeable than others, on the whole the Woodbine sand is fairly uniform as to porosity and saturation of oil; as the field is produced water takes the place of the oil, and forces the remaining oil in the field up-structure to the east; the pressure gradient is high on the west, low on the east, and while the reservoir fluids on the whole tend to move up-structure to the east, there is also migration of oil to areas where, from dense drilling, the withdrawals have been greater than in other areas; while the spacing rule of the Commission (Rule 37) contemplates a uniform drilling pattern of one well to 10 acres, the rule provides for exceptions, and at the time of the trial most of the approximately 26,000 wells in the field had been drilled as exceptions to a general spacing rule. At the time of the trial the average density of drilling in the field was one well to 5.133-acres, but many areas throughout the field had been drilled to a substantially greater density than the average of the field—for example, in numerous places the well density was substantially greater than one well to one surface acre; on the whole, a very large area around Respondent's lease was drilled more densely than Respondent's lease. Except in a few isolated areas, one well will effectively drain 10 acres in the East Texas Field. (R., 959-965, 973, 974, 976)

Facts are now, and for some years have been, available from which it is possible to determine with reasonable accuracy the character and thickness of the sands in the field, the type of well which will be obtained in any given area, and the recoverable oil in

the field as a whole. (R., 962) * * * "a wealth of information is already before the Commission from which it can determine the productivity, or at least the relative productivity, of the various leases in the field, in terms of relative recoverable oil under practical operating conditions." (R., 963) Position on the structure, sand thickness and distribution of allowables all enter into ultimate recovery from any lease. The natural advantage of a lease can be either increased or decreased by the method of distributing the field allowable. (R., 965)

While the Railroad Commission order fixed the daily field allowable at about 522,500 barrels of oil, and provided that each well shall be allowed to produce daily "a maximum of 2.32% of its hourly potential capacity as determined by the Commission," in the application and enforcement of this order (a) each well that could not produce as much as 20 barrels of oil per day was allowed to produce to the maximum of its capacity, (b) where 2.32% of the hourly potential of any well amounted to less than 20 barrels per day, the well was allowed to produce 20 barrels of oil per day, (c) where 2.32% of the hourly potential of any well amounted to more than 20 barrels of oil per day, such well was allowed to produce 2.32% of its hourly potential. This application of the order resulted in approximately 451 wells, not any one of which was capable of producing as much as 20 barrels per day, producing daily a total of approximately 5,250 barrels; in approximately 19,032 wells, with potentials ranging from 20 barrels of oil per day to 860 barrels per hour, each producing 20 barrels per day, or a total of approximately 380,640 barrels per day; in approxi-

mately 6,325 wells, having hourly potentials ranging from 865 barrels to about 1100 barrels, each producing 2.32% of its hourly potential, or a total of 136,610 barrels. The practical effect of the application of the order was to allow wells that could not produce as much as 20 barrels per day to produce to the maximum of their capacity, and to allow every other well in the field a minimum daily production of 20 barrels, leaving only approximately 7,000 barrels (less than 2%) of the daily field allowable to be prorated on a potential basis among approximately 6,325 wells having hourly potentials in excess of 865 barrels. (Averaged by the 6,325 wells, the 7,000 barrels of proratable oil equaled only slightly in excess of one barrel per well.) The spread between the daily allowable production of wells capable of producing only 20 barrels per day and those capable of producing 20,000 barrels per day was less than 6 barrels. (R., 969-972, 982-983)

The potential method of distributing the daily field allowable among wells was initiated in 1933, when the daily field allowable of approximately 750,000 barrels was prorated among less than 10,000 wells more uniformly spaced than the present drilling pattern of the field. Since that time the number of wells in the field has increased to nearly 26,000, and the daily field allowable has been reduced to about 522,000 barrels, with the result that the spread between the good wells and properties and the poorer wells and properties has become less and less, until under the plan of proration in question the field allowable is distributed almost 99% on a per well basis. Respondent's situation has completely changed since the potential method of distribution was adopted. Effect of the potential factor in the order is now practically nil. (R., 972-973, 991)

Respondent's 25-acre lease is situated near the center of the field in the "fairway," where the oil saturated sand is thick and the porosity and permeability of the sand is as high as in any part of the field; the sand under Respondent's lease averages 95 feet in thickness as compared with the average of 42 feet for the field; the hourly potential of each of Respondent's wells is placed at 964 barrels as compared with the field average of 605 barrels; Respondent's lease and wells are among the best in the field; five flowing wells have been drilled and are producing on Respondent's lease. The recoverable reserves originally under Respondent's lease were estimated at 60,000 barrels per acre, and at the time of the trial the recoverable reserves under its lease were estimated at about 46,000 barrels per acre. The daily allowable for Respondent's five wells was 111.83 barrels, or 4.4 barrels of oil per day per surface acre of the lease, or an average of 22.36 barrels per well per day, or only slightly in excess of two barrels more per day to each of Respondent's wells having hourly a potential of 964 barrels than was allowed to wells that could produce only 20 barrels per day. Other tracts more densely drilled, but not more favorably situated from the standpoint of reserves or position on the structure, were allowed to produce at rates as high as 200 barrels per surface acre per day; based on the minimum allowable of 20 barrels per day and the density of drilling on tracts, some areas were allowed to produce more oil per surface acre in one year than the combined production of Respondent's lease for a period of eight years. Many areas allowed the advantage of greater production are in portions of the field where the oil sand is thin and the reserves per acre are

much less than under Respondent's lease. In all directions from Respondent's lease there were more densely drilled areas where pressures are lower, and such conditions, in view of the drilling pattern and method of distribution, result in drainage of Respondent's lease and materially reduce Repondent's ultimate recovery. Adjoining Respondent's lease, R. M. Wood has drilled a well on an area, claimed by Respondent to be 1/10 of an acre, but by Petitioners to be 1 acre; this well is allowed to produce substantially as much as any of Respondent's wells. (R., 965, 974-978)

There are 2,374 acre feet of sand beneath Respondent's lease, or .04219% of the 5,586,000 acre feet of sand in the field; the daily allowable of Respondent's lease is only .02143% of the daily field allowable; to January 1, 1939, Respondent had produced from its lease 355,254 barrels of oil, or .027228% of the total of 1,340,730,000 barrels of oil produced from the field. While 37% of the estimated reserves of the field had been produced to January 1, 1939, Respondent had been allowed to produce only 23% of the reserves of its lease. These percentages are calculated from figures appearing in the findings at pages 976, 977 and 982. Respondent has produced 200,000 barrels less of oil than it would have produced if Respondent had been allowed to produce in the proportion that the reserves under its lease bear to the reserves in the field. The five wells on Respondent's lease are sufficient in number to recover the reserves of the lease under reasonable methods of proration. Respondent has for some seven years unsuccessfully appealed to the Railroad Commission for an adjustment of allowables,

and for relief from the damage resulting to it from the present plan of proration. (R., 976, 977, 978, 982, 991, 992.)

Oil reserves in the field and under the various leases can be calculated with reasonable accuracy. (R., 979, 980.)

The method of proration involved does not take into account the respective reserves under the various tracts or allow each producer to produce substantially in proportion to the recoverable oil under his tract, nor is there anything in the order or its application that takes into consideration the relative rights of operators to produce their fair shares of the oil; owners of leases are not given an equal opportunity to realize upon the known recoverable oil reserves of their respective leases; the method of proration involved denies to Respondent an opportunity to produce its fair share of the oil, and gives to others an opportunity to produce more than their fair share of the oil, and to drain oil from Respondent's lease. The allowables granted to poorer properties and small and densely drilled tracts, with the resulting greater recoveries allowed to these properties, result in drainage of the better and less densely drilled properties, including Respondent's lease, as well as a denial to Respondent of a fair share of the daily allowable. The only phase of the order that relates to the prevention of waste is the top daily field allowable; the present plan of proration causes unnecessary waste; the effect of the order is to take the oil of one operator and to give it to another. Respondent's lease is west of a line drawn through the approximate center of the field to the west of which line operators, under the method of proration in ques-

tion, will recover less than the amount of the reserves originally under their leases, while operators to the east of the line will, under such method of proration, recover more than the reserves originally under their leases. Under the present plan of proration Respondent is currently suffering loss and will not be permitted to recover ultimately a total amount of oil equivalent to the recoverable reserves under its lease, much less an additional amount which would be recoverable by virtue of the structural position of Respondent's lease; it is clear that under the present plan or one similar to it, time will not give Respondent an opportunity to recover its fair share of the recoverable oil in the field; even under the most favorable assumptions, an unreasonable time will have elapsed before there will even be a probable opportunity for Respondent to recover even a substantial part of its fair share of the reserves of the field. (R., 975-976, 980-987)

The per well method of distribution does not reduce avoidable drainage to a reasonable minimum. Reasonably avoidable drainage is aggravated by this method, to the material damage of Respondent. (R., 965) Methods of distribution have been suggested which, if adopted, would minimize the inequities and reasonably avoidable drainage resulting from the method of distribution in question. Numerous such plans are well known to the Commission and its engineers; they are workable and easy of administration. Many factors may properly be considered other than real potentials, or in connection with real potentials—such as sand thickness, surface area, recoverable reserves, pressures and location on the structure. Methods can be adopted which will be fair to all, and will give to Respondent an opportunity to produce its fair

share of the oil without being required to drill additional unnecessary wells to obtain such share. (R., 987-988). Any method of distributing the field allowable which gives to Respondent and others the opportunity to produce their fair shares of the allowable would not create as much waste as the method of distribution in question; and, on the contrary, some of the methods suggested would have a tendency to reduce waste. (R., 988-992)

From the standpoint of waste, none would occur if many wells in the field were shut in, plugged or allowed to produce as little as 5 barrels per day, although it might be advisable to produce every other day, or one day in three or four days, the average allowable of these wells rather than allowing them to produce their allowable each day. (R., 989) The finding is supported by testimony that many wells could be shut in without resulting in waste (R., 628, 634-635), and the wells could be produced at an average rate of 5 barrels per day (R., 276, 637). In contending that Respondent has conceded that a well minimum is necessary, Petitioners are incorrect,—evidently having given undue value to isolated language instead of considering the whole testimony, or having misconstrued the meaning of testimony that, if a minimum can lawfully be fixed, a 20 barrel minimum is not necessary to prevent waste or to make operations profitable, but that wells can be profitably operated without waste on a 5 barrel minimum per producing day, if the wells are properly operated.

In only two instances does Petitioners' brief refer to the findings of fact. These are at page 4 of the brief, in quoting the stipulation concerning the method of proration, and at page 42, in referring to

the trial Court's finding and conclusion that wells in the East Texas Field could be produced without waste at substantially less than 20 barrels each per day. How far the excerpts of testimony relied upon by Petitioners are in accord with the testimony as a whole could only be developed by setting forth the testimony at length; but how far these excerpts were rejected by the findings will appear by comparing the excerpts with the above statements from the findings of fact.

Petitioners contend that the trial Court attempted to write a proration formula for the Railroad Commission, and Respondent answers that the provision of the decree whereby the Commission is enjoined from interfering with Respondent in daily producing that proportion of the daily field allowable that 220 bears to 522,000 is to be construed as limiting the amount of oil that Respondent may produce without interference by the Commission, pending appeal or the writing of a valid order. If there ever was any doubt concerning the proper construction of that part of the decree, the doubt has been removed by the order of the Circuit Court of Appeals that the decree is without prejudice to the right of the Commission to make and enforce a valid order.

SUMMARY OF ARGUMENT

(1) The Texas rule of property is that the owner of land owns the oil and gas beneath it; that the owner of an oil and gas lease owns the oil and gas in place beneath the land affected by the lease.

(2) The Texas law is that under proration the owner of the oil and gas estate in land is entitled to "an equal opportunity with adjoining leaseholders of

developing and realizing for his leasehold"; or, otherwise stated, he is entitled to "a fair chance to recover the oil and gas in or under his land, or their equivalent in kind," that is, he is entitled to an opportunity "to recover a quantity of oil and gas substantially equivalent in amount to the recoverable oil and gas under his land."

(3) The reasonableness of the potential method of proration is unimportant in this case because the method of proration here involved was not a potential method, for approximately 99 per cent of the field allowable was divided among wells on a basis of 20 barrels per well. Such a per well basis of proration does not result in a distribution of the field allowable on a reasonable basis as is required by law, and is arbitrary and confiscatory, and has previously been condemned by the courts.

(4) The method of proration enforced to control production from Respondent's lease, not being necessary to prevent waste, and resulting in unnecessary and unreasonable drainage of Respondent's lease by other operators and in preventing Respondent's currently or ultimately recovering its fair share or proportionate share of the recoverable oil, was unreasonable and confiscatory, and the trial Court properly enjoined the enforcement of such method of controlling production from Respondent's lease, and the Circuit Court of Appeals properly affirmed that judgment.

(5) Respondent repeatedly protested being made to suffer from the injustice, inequities and unreasonableness of the method of proration here involved and timely brought this suit to protect its property from confiscation.

ARGUMENT

I.

The rule of property in Texas with respect to ownership of crude petroleum oil and natural gas is that an owner of land owns the oil and gas in place thereunder, and that under the conventional form of oil and gas lease, such as is involved in this case, the lessee owns the oil and gas in place.

Texas follows the absolute ownership view with respect to ownership of crude petroleum oil and natural gas, the rule of property in this State being that the land owner is regarded as having absolute title to the oil and gas beneath his land. (*Thompson vs Consolidated Gas Corp.*, 300 U. S. 55, 68; *Stephens County vs Mid-Kansas Oil & Gas Company*, 113 Tex. 160, 169, 254 S. W. 290, 294, 29 A. L. R. 566) It has been specifically held that this property right is not in any sense an undivided interest as of a cotenant or tenant in common in the entire reservoir. (*Magnolia Petroleum Company vs Zeppa* (Tex. Civ. App.), 70 S. W. (2d) 777, 779)

The lessee in a conventional form oil and gas lease, under the law of Texas, is regarded as owning the oil and gas beneath the land affected by the lease. (*Brown vs Humble Oil & Ref. Co.*, 126 Tex. 296, 305, 83 S. W. (2d) 935, 940; *Waggoner's Estate vs Sigler Oil Co.*, 118 Tex. 509, 517, 19 S. W. (2d) 27, 28)

Petitioners' brief concedes the law of Texas to be as here stated.

II.

The statutes of Texas empowering the Railroad Commission to make rules and regu-

lations for the prevention of waste of oil and natural gas limit the exercise of the powers granted by providing that in the event any regulation is adopted limiting the production of oil or natural gas in any pool, the Commission shall prorate or apportion the allowable production of the pool among the various producers "on a reasonable basis"; and the Supreme Court of Texas has declared that under proration every owner or lessee of land in the field has a right to a fair chance to recover the oil and gas in or under his land or their equivalent in kind.

At common law, as declared by the courts of Texas, a land owner could drill an unlimited number of wells upon his land and produce all of the oil and gas that could be produced from his wells. This right was limited by the right of the adjoining land owner to drill on his land and by producing oil and gas diminish production of the offset owner. Texas conservation statutes give the Railroad Commission power to limit enjoyment of this common law right when reasonably necessary to prevent waste.

The conservation statutes define waste (appendix, p. 36) and give the Railroad Commission power to make and enforce rules for the prevention of waste. Among the powers so granted to the Railroad Commission is the power to make and enforce regulations controlling the drilling of wells and the production of oil (Appendix p. 38). These powers of the Railroad Commission are not absolute but are limited. Their exercise is limited by the principle applicable in any exercise of the police power, namely, that the power

may be exerted to restrict the use and enjoyment of private property only to the extent reasonably necessary to protect the public interest. Then, the statutes which grant regulatory powers to the Railroad Commission also limit the exercise of the power.

Chapter 76, section 6, Acts of the Regular Session of the Forty-fourth Legislature of Texas, 1935, (Article 6049c, section 7, Vernon's Civil Statutes of Texas) provides that:

* * *

> "In the event any such rule, regulation or order which the Commission may adopt provides for the limitation or fixing of the production of crude petroleum oil, or of natural gas from wells producing gas only, in any pool or portion thereof, the Commission shall distribute, prorate, or otherwise apportion or *allocate, the allowable production among the various producers on a reasonable basis.*"
> * * * [1]

By imposing upon the Commission the duty to distribute or prorate the "allowable production among the various producers on a reasonable basis," the statute prohibits the Commission distributing the allowable production on any other basis. In so limiting the exercise of the powers granted, the statute recognizes the principle that under the due process and equal protection clauses of the Fourteenth Amendment to the Constitution of the United States, any arbitrary or unreasonable restrictions on production, or arbitrary or unreasonable method of allocating among owners the allowable production, would be void.

[1] Except where otherwise shown, all emphasis is ours.

"Reasonable basis" as used in this connection means a basis that will protect the rights of the respective land and lease owners by not unnecessarily restricting their use of their property and by not taking unnecessarily the property of one person and giving it to another. (*Lilly vs Conservation Commission of La.* 29 Fed. Supp. 892, 893, 897.)

Any basis of restricting production or of distributing the field allowable among wells that is not reasonable or that otherwise results in an arbitrary or unreasonable taking of property is contrary to the statutes and is violative of the due process clause of the Fourteenth Amendment to the Constitution of the United States. Such regulation would be unreasonable and arbitrary within the meaning of the Fourteenth Amendment, because it would be an instance of an administrative agency attempting to exercise power not granted by law; and, independent of the statute, such a regulation, because of its arbitrary and unreasonable character, would be violative of the Fourteenth Amendment. Compare: *Ohio Oil Co. vs. Indiana*, 177 U. S. 190, 210; *Bandini Co. vs. Superior Court*, 284 U. S. 8, 18; and *Champlin Rfg. Co. vs. Commission*, 286 U. S. 210, 233.

Not only do the statutes require that the allowable of a field be distributed on a reasonable basis, and so prohibit distribution on any other basis, but the Supreme Court of Texas and various intermediate appellate courts have construed the conservation statutes and declared property rights to require that proration regulations be administered in a manner that will allow land or lease owners a reasonable opportunity to realize upon their property. In *Bass vs Railroad Commission*,

(Civ. App.), 10 S. W. (2d) 586, 588, passing upon the right of a lease owner to drill wells under the Railroad Commission's well spacing rule, the Court held that the test of reasonableness in administration of the rule was whether or not an operator "would have an equal opportunity with adjoining leaseholders of developing and realizing for his leasehold."

In *Brown vs Humble*, 126 Tex. 296, 309, 312; 83 S. W. (2d) 935, 942, 944, involving the Railroad Commission's well spacing rule, the Court quoted with approval from *Ohio Oil Co. vs. Indiana*, 177 U. S. 190, 202, involving the owner's right to the unrestricted production of oil and gas from his land, in part, as follows:

> * * * Hence it is that the legislative power, from the peculiar nature of the right and the objects upon which it is to be exerted, can be manifested for the purpose of protecting all the collective owners, by securing a *just* distribution, to arise from the enjoyment, by them, of their privilege to reduce to possession, and to reach the like end by preventing waste."

Continuing, the Supreme Court of Texas, speaking through Mr. Justice Sharp, said:

> * * * "The exercise of the police power under this rule (spacing rule) does not change the rule of property. It merely regulates and controls the way in which his property shall be used and enjoyed. Each person still owns the oil and gas in place under his land, and each still has the right to possession, use, enjoyment, and ownership of the oil and gas produced through wells located on his land, re-

gardless of its origin. The primary rule of ownership is still operative. The rule of convenience becomes secondary.

"Conditions may arise where it would be proper, right, and just to grant exceptions to the rule so as to permit wells to be drilled on smaller tracts than prescribed therein. Also, conditions may arise where it would be proper, right, and just to permit tracts to be subdivided and such subdivisions drilled after the adoption of the rule; but in all such instances it is the duty of the commission to adjust the allowable, based upon the potential production, so as to give to the owner of such smaller tract only *his just proportion* of the oil and gas. By this method each person will be entitled to recover a quantity of oil and gas substantially equivalent in amount to the recoverable oil and gas under his land." * * *

"The commission, in order to prevent waste, has the power to limit the rate of flow in the same way that it has the power to regulate spacing. * * * This right to control the rate of of flow in order to prevent waste also enables the commission to offset the advantage obtained by one who is given an exception to the spacing rule by limiting his allowable production to the extent necessary to overcome this advantage. In this way the commission, by controlling the oil stored in the common reservoir, is enabled to carry out the dominant purpose of preventing waste, and at the same time, permit each owner to enjoy the opportunity fully to realize upon his estate by developing and recovering his oil and gas." * * *

In the case of *Gulf Land Company vs Atlantic Refining Company* (Texas Supreme Court, not yet of-

ficially reported), 131 S. W. (2d) 73, 80, involving an order granting a permit to drill a well in exception to the well spacing rule, the Court, speaking through Mr. Justice Critz, said:

> "It is the law that every owner or lessee of land is entitled to a fair chance to recover the oil and gas in or under his land, or their equivalents in kind."

The right of an owner or lessee of land to produce his fair share of the oil and gas and to a reasonable opportunity to recover the recoverable reserves under his land and to have allowables adjusted to attain this end was recognized in *Magnolia Petroleum Company vs. Blankenship*, 85 Fed. (2d) 553, 555 (Fifth Circuit) (writ refused, 299 U. S. 608). In that case, the Court, speaking through Judge Sibley, said:

> "Blankenship having been refused a permit for a well on his small tract would have been unable to save any of his oil unless by some arrangement, voluntary or forced, he could share in the oil produced from nearby wells. But he now has a well and is at peace with the commission and the state. The question is, What are the private obligations between him and his neighbor Magnolia? Before the conservation statutes, each could have put on his own land all the wells desired without accountability to the other. The law through the commission has stopped that. But an owner unable to protect himself from drainage by an offset well is given the right to petition the commission and the commission has power and a consequent duty to 'prevent injury to adjoining property,' and touching a common pool or portion of it to 'distribute, prorate or other-

wise allocate the allowable production among the various producers.' This we think is the remedy which Magnolia should seek if it believes that Blankenship is getting more than his fair part of the oil. * * * We are of opinion that Blankenship's well, whether lawfully put down or not, ought not to be permanently closed at the instance of Magnolia, and that Magnolia's preventive remedy if Blankenship is producing too much oil is to apply to the commission for a rule of proration among all the competing wells."

* * *

* * * "Magnolia Petroleum Company is given no authority to enforce the commission's rules and orders, but can only assert its own private rights. We hold that it has under the circumstances of this case, which include the commission's refusal to question Blankenship's right to operate his well, no equity to a permanent injunction, but that if its oil lands are being unduly drained by Blankenship's well and by the other two wells on the same two-acre tract which before subdivision in 1933 was a unit of less than twenty acres, the legal and sufficient remedy is to obtain a proration adjustment order from the commission. * * * We suppose that if the commission denies to any subdivision of such tract its own well that it can make some just apportionment of the oil produced on those subdivisions which are allowed wells; * * * It is for the commission on a hearing for a proration order to say what production should be allowed to the whole two-acre tract as against Magnolia and other adjoiners, and within that tract what proportion if any of the production allowed to it should be awarded to Blankenship's well as against the other two wells previously on the tract."

The opinions in the *Brown vs Humble Oil & Refining Company* and *Magnolia Petroleum Company vs Blankenship* cases, *supra*, have been cited with approval in numerous other cases. See *Sun Oil Co. vs Gillespie*, (Tex. Civ. App.) 85 S. W. (2d) 652, 654, writ dismissed; *Atlantic Oil Producing Company vs Railroad Comm. of Texas*, (Tex. Civ. App.) 85 S. W. (2d) 655, 658; *Humble Oil & Refining Company vs Lasseter*, (Tex. Civ. App.) 95 S. W. (2d) 730, 732, writ dismissed; *Stanolind Oil & Gas Company vs Railroad Commission* (Tex. Civ. App.), 96 S. W. (2d) 664, 665, writ dismissed.

In *Peoples Petroleum Producers, Inc. vs Smith et al*, 1 Fed. Sup. 361, 365, the Court, speaking through Judge Hutcheson, said:

> * * * "in direct contravention of the statute, instead of justly and equitably distributing the reduction ordered, it has, through its per well requirement, so arbitrarily, unjustly, and in a confiscatory way distributed it, as that it will inevitably take the oil of plaintiffs, situated as they are most favorably on the structure, to give it to others not so favorably situated."

It is the settled law of Texas that under proration the allowable of a field must be equitably distributed among the leases and wells, preserving to each owner substantially that which he owns, and if a proration method "strips the best properties down to the level of the worst and takes from one owner to give to another," the attempted regulation is contrary to law.

The statutory law of Texas and the property rights of land and lease owners, as declared by the courts,

require an equitable and reasonable distribution of the field allowable among lease operators. Any method of proration adopted by the Commission which does not distribute the field allowable on a reasonable basis is void because the power to adopt and enforce such a method has not been, and in law could not be, granted to the Railroad Commission. The Fourteenth Amendment is a bar to any attempt to authorize a distribution of the allowable on any basis other than a reasonable basis, as it is also a bar to any attempt to distribute the allowable on any other basis.

III.

The proration order involved here does not prorate the field allowable on a reasonable basis, but, as applied and enforced, prorates the field allowable substantially on a per well basis, an arbitrary and unreasonable basis; and, as applied and enforced, to control production from Respondent's lease, it operates to confiscate Respondent's property.

The words in which the Railroad Commission's proration order is cast are unimportant; the manner in which it is construed, applied and enforced by Petitioners is important. The findings of fact disclose how the order is applied and enforced, and the effect thereof upon Respondent's property. The statement of the nature of this case discloses the effect of the order as applied to Respondent.

The findings of fact establish that Respondent's lease, located in the best part of the field, has a sand thickness of approximately 95 feet; that the potential of each of Respondent's wells is 964 barrels per hour.

It is also established by the findings that while Respondent's lease comprises .0188 per cent of the surface area of the field, the acre-feet of oil sand under Respondent's lease equals .04219 per cent of the total acre-feet of sand in the field. The allowable for Respondent's 5 wells was only .02143 per cent of the daily field allowable; Respondent had been allowed to produce only .027228 per cent of the oil produced from the field up to January 1, 1939, notwithstanding the fact that .04219 per cent of the acre-feet of sand in the field was under Respondent's lease. (R., 982) It is also established by the findings that under the method of proration enforced to control production from Respondent's lease that each of Respondent's wells, with a potential of 964 barrels per hour, or over 20,000 barrels per day, is allowed to produce only slightly in excess of two barrels more per day than the daily allowable granted wells which can produce only 20 barrels per day, or less than 1 barrel per hour.

The well drilled on the Wood tract, adjoining Respondent's lease, is allowed to produce approximately the same amount of oil per day as any one of Respondent's wells, with the result that if the Wood lease comprises 1 acre, as contended by Petitioners, the Wood lease is allowed to produce five times as much per surface acre per day as Respondent's lease; and if the Wood lease comprises 1/10 of an acre, as testified by one of Respondent's witnesses, then the Wood lease is allowed to produce fifty times as much oil per surface acre per day as Respondent's lease. The findings of fact establish, and they are not challenged, that many areas in the field are drilled to a density greater than one well to less than 1 acre and that some of these tracts, allowing to their wells 20 barrels per day, are producing ap-

proximately fifty times as much per surface acre per day as Respondent's lease. (R., 975) The order in allowing these disproportionate recoveries does not distinguish between tracts with thin sand and small reserves and the tracts with thick sand and large reserves. (R., 969)

In distributing the field allowable no account is taken of density of drilling, sand thickness, reserves, acreage of leases, true potentials, bottom hole pressures, or any other factor by which can be measured the reserves of a lease or its capacity to produce. (R., 981) Only approximately 7,000 barrels of the daily field allowable of more than a half million barrels of oil is distributed other than on a per well basis. The 7,000 barrels over and above that part of the daily field allowable absorbed by the weak wells and by the 20-barrel minimum are divided out among approximately 6,325 wells, with the result that no well in the field (even wells like Respondent's, capable of producing as much as 20,000 barrels of oil per day) is allowed to produce as much as 6 barrels more of oil per day than the allowable of wells which can produce not exceeding 20 barrels per day. Approximately 99 per cent of the field allowable is distributed among wells on a flat per well basis without distinction as to density of drilling, reserves, position on the structure, true potentials, bottom hole pressures, or any other factor by which can be measured the value of a property or the capacity of a well or lease to produce. In the application and enforcement of the order, the best properties in the field are reduced to substantially the level of the poorest properties in the field. Under such a method of proration ownership of large acreage means nothing, ownership of many twenty barrel wells

means everything; ownership of thick sands and large reserves means nothing, a densely drilled tract means everything. This method of proration causes a densely drilled tract of poor reserves to pay greater daily production dividends than a less densely drilled tract of rich reserves. The practical effect of the order can be vividly demonstrated by comparing two 5-acre adjoining leases in any part of the field, one having one well, the other having five wells. The method in question permits the 5-well lease to produce 5 times as much oil per day as the 1-well lease, although one well is sufficient to produce the oil from five acres. The one produces five times as fast as the other. It cannot be disputed that such a method of proration operates to deny equal opportunities to operators, and to take one man's property and give it to another.

Respondent's objections to this method of proration are not answered by saying that Respondent may drill more wells and by producing them secure more oil. This is true, first, because Respondent has applied for permits to drill additional wells and was granted a permit to drill only 1 additional well (R.,978) which, under the order in question, would allow Respondent to produce only about 22 additional barrels of oil per day; second, because the 5 wells on Respondent's lease are sufficient to produce the recoverable oil thereunder, and to require Respondent to drill additional wells, when existing wells are sufficient under proper regulations to produce the recoverable oil under the the lease, would subject Respondent to a confiscation of its property to the extent of drilling, operating and other costs; and, third, if Respondent drilled more wells and others followed his example, the purpose of obtaining more oil would not be attained because the

division of 522,500 barrels field allowable, fixed to prevent waste, would be divided among more wells and the per well allowable would be reduced.

The trial court stated: "The proration of this field on a per well basis has been considered and condemned in a number of cases before this. See *Peoples Petroluem Producers, Inc. vs Smith et al*, 1 Fed. Sup. 361; *Peoples Petroleum Producers, Inc. vs Lon A. Smith et al*, Equity No. 386, Tyler Division, Eastern District of Texas, decided March 17, 1933, unreported; *Rowan & Nichols Oil Company vs Terrell et al*, Equity No. 479, Tyler Division, Eastern District of Texas, decided March 17, 1933, and unreported." (R., 69)

The Supreme Court of Oklahoma in *Patterson vs Stanolind Oil and Gas Co.*, 182 Okla. 185, 77 Pac. (2d) 83, 88, after having quoted from *Ohio Oil Company vs Indiana, supra*, and *Champlin Refining Co. vs Corporation Commission, supra*, held that, in prorating production from a field, the administrative agency, even in a state where the ownership in place rule does not prevail, must direct a "just distribution" among the various owners of mineral rights, and quoted with approval a part of Judge Kennamer's dissenting opinion in the Champlin case (51 Fed. (2d) 823, 834), as follows:

> "*Acreage is ignored* and an operator with two 5,000 barrel wells on 5 acres may take out of the common source of supply, under the provisions of section 4, as much oil as an operator with two 5,000 barrel wells on 20 acres in the same field. *Proportionate taking per well* is wholly inequitable if the Legislature intends to secure 'a just distribution, to arise

> from the enjoyment * * * of their privilege to reduce to possession', because the operator with 20 acres has four times as much privilege as the operator with 5 acres in the same field.

Petitioners argue that proration on the basis of potential of wells is the best practical means of allocating the allowable according to productive capacity of wells. Respondent considers that the argument is beside the question because the findings in this case show that the field is not prorated on a potential basis, but substantially on a per well basis. But, if the merits of the potential method were involved, then Petitioners' argument is answered by unchallenged findings of the trial Court as follows:

> * * * "The most that can be said of a potential is that it reflects accurately only the mechanical efficiency of a well to produce at the time and under the conditions existing when the test was made. Relatively, it may indicate in some small way other factors. * * * Two potential tests taken on wells on adjoining tracts, where the sand and other reservoir conditions are substantially the same, will show substantially the same potential only where like equipment is used, the same penetration is made into the sand, and the same back pressure maintained on the wells when the tests are made. Wells throughout the field are equipped and drilled differently." (R., 967-968)

Since wells in the East Texas Field are not drilled on uniform spacing it is obvious from the above quoted finding that potentials, even if accurately taken, would

not form a reasonable basis for distributing the field allowable. See also Record, pp. 968-969, 980, 981.

Petitioners contend that whatever may be the infirmities of the method of proration involved, Respondent failed to show a present injury or that under the present plan of proration it will not, during the life of the field, be allowed to recover its share of the oil. In support of this contention Petitioners argue that there is in place beneath Respondent's lease at this time substantially the same amount of oil as was in place originally and compare the average production per surface acre from Respondent's lease with production from the field.

In discussing the amount of oil beneath Respondent's lease, Petitioners speak in terms of barrels of oil under the land but carefully avoid mention of *recoverable oil*. The finding of the Court was that the recoverable reserves originally in place under the lease were estimated at 60,000 barrels per surface acre; that the reserves under Respondent's lease at the time of trial were estimated at 46,000 barrels per acre. (R., 976)

In stating that production from Respondent's lease up to the time of trial averaged 14,210 barrels per acre, as compared with 9,810 barrels per acre for the field, Petitioners speak in terms of surface acres and carefully avoid making the comparison on the basis of production per acre foot of sand. Surface acreage alone does not measure reserves beneath a lease. The number of feet of saturated oil sand multiplied by surface acreage gives the number of acre feet of sand beneath a lease; and permeability and porosity being substantially uniform, as is the case in the East Texas Field, acre feet of sand forms a fair basis of comparing leases for reserves. The average sand

thickness in the field is 42 feet; the average sand thickness under Respondent's lease is 95 feet. (R., 982) That is to say, averaging the field, every surface acre represents 42 acre feet of sand; while, as compared with the average, every surface acre of Respondent's lease represents 95 acre feet of sand. Respondent's accumulated production of 14,210 barrels per surface acre, expressed in production per acre foot of sand, is 149 barrels per acre foot; while the average for the field is 229 barrels per acre foot of sand. Respondent, therefore, has been allowed to produce per acre foot of sand only 65 per cent of the average of the field. This discrimination against Respondent could not be explained by charging Respondent with delay or neglect, nor do Petitioners attempt to do so or otherwise explain it, for the record shows that Respondent was diligent in developing its lease.

The arguments of Petitioners in support of their contention that Respondent failed to establish that it had been injured by the method of proration involved and had also failed to establish that the method would prevent Respondent's ultimately recovering its fair share of the oil are grounded upon excerpts quoted from the testimony. The findings of fact completely answer the contention and every argument advanced in support of it. The trial Court found that the method of proration in question resulted in drainage of Respondent's property (R., 965, 981); that Respondent was currently suffering loss of its oil by reason of the enforcement of the order (R., 982-987); that under the method of proration in question, or any similar method, Respondent would not ultimately recover the reserves under its lease or their equivalent (R., 980, 981, 987)

Petitioners assert that Respondent failed to establish that the minimum allowable of 20 barrels per well was not reasonably necessary to prevent waste and confiscation of property. The record does not justify the assertion.

The trial Court found that the 20 barrel minimum was not necessary to prevent waste. In support of this finding, the trial Court had not only the testimony of witnesses introduced by Respondent that it was not necessary to prevent waste, but also the testimony of Petitioners' witnesses that the wells could be operated on less than 20 barrels per day (see Hudnall's testimony, R., 522-524, 552; and Cottingham's testimony, R., 405-406, 410-411). The allowance of 20 barrels minimum to all wells in the densely drilled areas in the eastern part of the field, where the pressures are low, causes excessive withdrawals and resulting unnecessary loss in pressure and abandonment of wells, which is waste (R., 586-587, 963, 965, 973-978, 981, 991). The finding is further supported by undisputed testimony that over a period of years wells have been operated on less than 5 barrels per day. The total production of wells that could not produce as much as 20 barrels per day was approximately 5,250 barrels of oil,—or an average of slightly in excess of 11 barrels per well per day (R., 970). The Circuit Court of Appeals stated that there was undisputed evidence tending to show that a pumping well averaging 5 barrels production per day can be operated with some profit and that it followed that flowing wells producing the same quantity of oil could be operated at a larger profit (R., 1109).

The 20 barrel minimum, therefore, was shown not to be necessary to prevent waste. Moreover, the 20 barrel minimum absorbs so much of the daily field al-

lowable that the better wells and properties cannot, within the field allowable, be allowed their fair share of the production. The influence of the 20 barrel minimum causes the method of proration in question to reduce the best leases and wells in the field to the level of the poorest leases and wells, causing an arbitrary discrimination in the proration of the field allowable and confiscation of Respondent's property.

The trial Court's finding that several methods of distribution have been suggested which, if adopted, would minimize the inequities and the reasonably avoidable drainage resulting from the present method of distribution, and that numerous such plans are well known to the Commission and its engineers and are workable and easy of administration, shows that the Commission could, if it were willing, give relief from the inequities and injustices of the method of proration attacked in this suit. (R., 987, 988)

IV

Respondent repeatedly, over a period of years, protested the inequities and injustices of the present order and timely brought this suit.

The trial Court found, and the finding is supported by undisputed evidence, that Respondent had constantly protested to the Commission with regard to the order and had appeared in court protesting the same and had applied alternatively for permits to drill additional wells, however unnecessary they might have been to the production of its oil. The Court further found that Respondent's protests to the Commission did not result in the Commission's granting Respondent relief. (R., 991-992)

Abie State Bank vs Bryan, Governor, 282 U. S. 765, 776, answers Petitioners' contention that Respondent has accepted the benefits of the order and cannot now dispute its validity. *Thompson vs Consolidated Gas Corp.*, 300 U. S. 55, 80.

V

The trial Court did not adopt a particular method of proration.

Petitioner's argument that the judgment of the trial Court adopted a method of proration that would be discriminatory and confiscatory is based upon that provision of the trial Court's decree whereby the Commission is enjoined from interfering with Respondent in daily producing that proportion of the daily field allowable that 220 bears to 522,000. In the trial Court's opinion (R., 75) it was stated that Respondent had not prayed the Court "for a sweeping writ, allowing it to produce its wells without restriction." The proper construction of the pertinent provision of the decree is that by enjoining the Commission from interfering with Respondent in producing the stated amount of oil the Court was limiting the amount of oil Respondent could produce pending appeal or promulgation by the Commission of a valid proration order.

If there ever was any question about the proper construction of this provision of the decree that question has been set at rest by the following language in the opinion of the Circuit Court of Appeals:

> In order to remove any doubt as to the temporary character of the ratio fixed by the District Court, the judgment will be amended to read 'without prejudice to the right of the Commission to enter a reasonable proration order and to fairly enforce it.'" (R., 110)

WHEREFORE, Respondent submits that the method of proration involved was not necessary to prevent waste, but tended to cause waste; and was arbitrary and unreasonable, and operated to confiscate Respondent's property, and that the judgment of the trial Court and Circuit Court of Appeals should be affirmed.

Respectfully submitted,

s/ DAN MOODY,
RICE M. TILLEY,
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By Dan Moody

APPENDIX

(All Statutes Listed Below are Included in Texas Revised Civil Statutes, 1925, or Amendments as Indicated, and are Compiled in Volume 17 of Vernon's Annotated Civil Statutes of Texas)

Art. 6014. "Waste"

The production, storage or transportation of crude petroleum oil or of natural gas in such manner, in such amount, or under such conditions as to constitute waste is hereby declared to be unlawful and is prohibited. The term "waste" among other things shall specifically include:

(a) The operation of any oil well or wells with an inefficient gas-oil ratio, and the Commission is hereby given authority to fix and determine by order such ratio provided that the utilization for manufacture of natural gasoline of gas produced from an oil well within the permitted gas-oil ratio shall not be included within the definition of waste.

(b) The drowning with water of any stratum or part thereof capable of producing oil or gas, or both oil and gas, in paying quantities.

(c) Underground waste or loss however caused and whether or not defined in other subdivisions hereof.

(d) Permitting any natural gas well to burn wastefully.

(e) The creation of unnecessary fire hazards.

(f) Physical waste or loss incident to, or resulting from, so drilling, equipping, locating, spacing or operating well or wells as to reduce or tend to reduce the total ultimate recovery of crude petroleum oil or natural gas from any pool.

(g) Waste or loss incident to, or resulting from, the unnecessary, inefficient, excessive or improper use of the reservoir energy, including the gas energy or water drive, in any well or pool; however, it is not the intent of this Act to require repressuring of an oil pool or that the separately owned properties in any pool be unitized under one management, control or ownership.

(h) Surface waste or surface loss, including the storage either permanent or temporary of crude petroleum oil, or the placing any product thereof, in open pits or earthen storage, and all other forms of surface waste or surface loss, including unnecessary or excessive surface losses, or destruction without beneficial use, either of crude petroleum oil or of natural gas.

(i) The escape into the open air, from a well producing both oil and gas, of natural gas in excess of the amount which is necessary in the efficient drilling or operation of the well.

(j) The production of crude petroleum oil in excess of transportation or market facilities or reasonable market demand. The Commission may determine when such excess production exists or is imminent and ascertain the reasonable market demand.

The Commission may consider any or all of the above definitions, whenever the facts, circumstances or conditions make them applicable, in making rules, regulations or orders to prevent waste of oil or gas.

Nothing in this Section shall be construed to authorize limitation of production of marginal wells, as such marginal wells are defined by Statute, below the amount fixed by Statute for such wells. (Acts 1919 p. 285; Acts 1929, 41st Leg., p. 694, ch. 313; Acts 1931,

42nd Leg., 1st C. S., p. 46, ch. 26, par. 1; Acts 1932, 42nd Leg., 4th C. S., p. 3, ch. 2, par. 1; Acts 1935, 44th Leg., p. 180, ch. 76, par. 2.)

Art. 6029. Rules and regulations

The Commission shall make and enforce rules, regulations or orders for the conservation of crude petroleum oil and natural gas and to prevent the waste thereof, including rules, regulations or orders for the following purposes:

(1) To prevent the waste, as hereinbefore defined, of crude petroleum oil and natural gas in drilling and producing operations and in the storage, piping and distribution thereof.

(2) To require dry or abandoned wells to be plugged in such way as to confine crude petroleum oil, natural gas, and water in the strata in which they are found and to prevent them from escaping into other strata.

(3) For the drilling of wells and preserving a record thereof.

(4) To require wells to be drilled and operated in such manner as to prevent injury to adjoining property.

(5) To prevent crude petroleum oil and natural gas and water from escaping from the strata in which they are found into other strata.

(6) To establish rules and regulations for shooting wells and for separating crude petroleum oil from natural gas.

(7) To require records to be kept and reports made.

(8) It shall do all things necessary for the conservation of crude petroleum oil and natural gas and to prevent the waste thereof, and shall make and enforce such rules, regulations or orders as may be necessary to that end.

(9) To provide for the issuance of permits, tenders, and other evidences of permission when the issuance of such permits, tenders, or permisison is necessary or incident to the enforcement of its rules, regulations, or orders for the prevention of waste. (Acts 1919, p. 285; Acts 1931, 42nd Leg., 1st C. S., p. 46, ch. 26, par. 15; Acts 1932, 42nd Leg., 4th C. S., p. 3, ch. 2 par. 7; Acts 1935, 44th Leg., p. 180, ch. 76. par. 4.)

Article 6049 c, Title 102, Revised Civil Statutes,

* * *

Section 7. * * *

In the event any such rule, regulation or order which the Commission may adopt provides for the limitation or fixing of the production of crude petroleum oil, or of natural gas from wells producing gas only, in any pool or portion thereof, the Commission shall distribute, prorate, or otherwise apportion or allocate, the allowable production among the various producers on a reasonable basis. Acts 1935, 44 Legislature, p. 180, ch. 76, sec. 6)